No. 93 1338

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1993

J. ALEXANDER SECURITIES, INC.,

Petitioner,

vs.

SIGNE MENDEZ,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CALIFORNIA COURT OF APPEAL FOR THE SECOND APPELLATE DISTRICT

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QUESTIONS PRESENTED FOR REVIEW

SHOULD ARBITRATORS BE EMPOWERED TO AWARD PUNITIVE DAMAGES WHEN THE PARTIES' AGREEMENT IS SILENT ABOUT DAMAGES?

1. Rule 10.1(c). Can the extreme reluctance of courts to review arbitration awards be reconciled with the constitutional requirements for reasonable Due Process constraints on punitive damage awards enunciated in this Court's recent Haslip decision?

2. Rule 10.1(a). Is a New York choice-of-law provision in an arbitration agreement enforceable even if the effect is to prohibit arbitrators from awarding punitive damages or is there a federal substantive or "arbitration" law [i.e.

Federal Arbitration Act], which preempts the application of state law? Can the narrow reading of preemption by the Second Circuit in Fahnestock & Co. v. Waltman be reconciled with conflicting decisions of the First, Ninth and Eleventh Circuits?

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Ralph B. Perry III on behalf of J. Alexander Securities, Inc. ("Alexander"),[1] petitions for a writ of certiorari to review the decision of the

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[1] Petitioner has no parent or subsidiary corporations or affiliates.

California Court of Appeal in this case.

OPINIONS BELOW

The opinion of Division Two of the California Court of Appeal for the Second Appellate District is reported at 17 Cal.App.4th 1083, 21 Cal.Rptr. 2d 826 (1993). The trial court opinion of the Los Angeles Superior Court was not reported.

JURISDICTION

The decision of the California Court of Appeal (See Appendix A, infra) was filed on August 9, 1993. A timely petition for review was then filed with the California Supreme Court; the petition for discretionary review was denied on November 24, 1993, with two Justices voting for review (four votes

required for review) (App. B); by such denial, the Court of Appeal became the "state court of last resort." (Rule 13.1). Jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

STATEMENT OF THE CASE

Mendez opened a securities account with petitioner Alexander, a small Los

Angeles securities broker-dealer, by executing a Cash Account Agreement (the "Agreement") providing that any disputes be resolved by arbitration before the New York Stock Exchange, Inc. ("NYSE") or the National Association of Securities Dealers, Inc. ("NASD"). C1:13-14 (¶ 9).[2] The Agreement also provided that its interpretation and enforcement would be governed by New York law. Id. (¶ 4).

After the value of the securities in the account declined, Mendez accused Weber, her broker of thirty years, and Alexander of churning, unsuitability and unauthorized trades. Originally Mendez sought only compensatory damages but

[2] Other than attached Appendix (A, B and C) all references are to pages of the official appendix of the record on appeal (any cite with "App." is to the attached Appendix).

later she amended her claim to seek additional compensatory damages and also punitive damages. Mendez chose arbitration pursuant to the Rules and Regulations of the NASD.[3] The matter was heard in Los Angeles by three arbitrators[4] and they rendered an award in March, 1992, consisting of four brief paragraphs: the first paragraph awarded $27,000 in compensatory damages against

[3] A complete set of the NASD Rules is set forth at C9:192-211.

[4] The Opinion states more than once that the three arbitrators were selected by the parties. App. A31. This is not correct. The arbitrators are selected by the NASD with each party having one peremptory challenge. The Opinion also suggests there is actually a benefit from the arbitrators being "from the trade." App. A31-32. This too is incorrect; NASD rules require that in matters involving public customers a majority of the panel must not be from the securities industry. See NASD Code of Arbitration, § 19 (App. C4).

the broker (Weber) and the firm (petitioner Alexander); the second paragraph awarded $27,000 in punitive damages against petitioner Alexander only for "failure to meet its duty and obligation to supervise [Weber]"' and the third and fourth paragraphs dealt with costs, fees and interest. C1:16.

Petitioner filed in the California Superior Court a Petition to Correct Arbitration Award by which petitioner sought only correction by eliminating the second paragraph providing for punitive damages, without affecting the merits of the decision, or the compensatory award, or the provisions for costs, fees and interest.[5] Petitioner argued to the

[5] "The arbitrators exceeded their powers but the award may be corrected without affecting the merits of the decision upon the controversy submitted."

trial court that the punitive damage portion of the award was in excess of the arbitrators' powers because there was no express agreement to submit to punitive damages and there were (1) no Due Process safeguards or constraints to such an award as required by this Court's decision in Pacific Mutual Life Ins. Co. v. Haslip, 499 U.S. 1, 111 S.Ct. 1032, 113 L.Ed. 2d 1 (1991); and (2) the parties' choice of law provision provided for the application of New York law and under such law arbitrators were prohibited from awarding punitive damages under Garrity v. Lyle Stuart, Inc., 40 N.Y.2d 1354, 353 N.E.2d 793 (Ct. of App. 1976). (C1:30-38).

The petition was heard by the trial

California Code of Civ. Proc., § 1286.6(b); see also §1285. App. C2-3.

court and denied without a statement of decision, (C12:215), and judgment was entered denying the petition and confirming the award on August 24, 1992. (B:4-5). An appeal was taken and the California Court of Appeal for the Second Appellate District affirmed by its written opinion filed August 9, 1993. (App. A). Thereafter a Petition for Review was filed in the California Supreme Court, which was denied on November 24, 1993, with two Justices (of four votes required) voting for review. (App. B). The denial formally rendered the California appellate court the "state court of last resort." (Rule 13.1).

The California Appellate Court gave the constitutional argument short shrift, relying on prior California and Ninth Circuit cases which did not deal with

Haslip at all.[6] The California court also held that the arbitrators had not exceeded their powers in awarding punitive damages for two reasons: (1) federal preemption cases held that a choice of law provision did not deprive the arbitrators of authority to award punitive damages but only provided the substantive law as to whether given conduct would warrant punitive damages, see Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1978 (11th Cir. 1988); and (2) without any express language in their contract but given the strong policies favoring arbitration the agreement could still be read as "contemplating" an award of punitive damages.

REASONS FOR GRANTING THE WRIT

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[6] See further discussion of these cases at pp. 22-24 infra.

I. THE DECISION OF THE STATE COURT BELOW, IN UPHOLDING AN ARBITRATION AWARD OF PUNITIVE DAMAGES IN THE ABSENCE OF ANY EXPRESS AGREEMENT BY THE PARTIES AS TO PUNITIVE DAMAGES, CONFLICTS WITH THE REASONABLE DUE PROCESS CONSTRAINTS ON SUCH PUNITIVE AWARDS REQUIRED BY THIS COURT'S 1991 HASLIP DECISION.

In this Court's recent decision in Pacific Mutual Ins. Co. v. Haslip, supra, punitive damages barely withstood a challenge that such damages were a per se violation of a defendant's due process rights. Justice O'Connor, in her dissent, carefully catalogued the dangers of the "powerful weapon" of punitive damages with highly vague instructions resulting in an almost standardless discretion to the jury or trier of fact.

111 S.Ct. at 1056. Justice O'Connor argued that post-verdict judicial review could not cure such faulty procedures and that Alabama's punitive damages scheme was indistinguishable from the common law schemes employed by many states. "Any award of punitive damages rendered under these procedures, no matter how small the amount, is constitutionally infirm." 111 S.Ct. at 1056 (O'Connor, J., dissenting). Other members of this Court have indicated due process concerns with punitive damages. See, e.g., Browning-Ferris Indus. v. Kelco Disposal, Inc., 492 U.S. 257, 278, 109 S.Ct. 2909, 2921 (1989).

Justice Blackman, writing for the majority of the Court, in Haslip held that the common law method for assessing punitive damages was not "per se

unconstitutional." The core of the majority opinion then was that analyzing Alabama judicial procedures from instructions to the jury and its post-trial procedures for scrutinizing punitive damage awards, including review by the trial court and the Alabama Supreme Court, and noting that Pacific Mutual had had the benefit of the "full panoply of Alabama's procedural protections," held that: "The application of these standards, we conclude, imposes a sufficiently definite and meaningful constraint on the discretion of Alabama fact finders in awarding punitive damages." 111 S.Ct. at 1045, 1046.

The Court refused to draw a "mathema tical bright line" in Haslip as to the amount of punitive damages which could be

considered "excessive."[7]

Usually an arbitration award will not be set aside in the c urts unless it evidences a "manifest disregard for law." See, e.g., United Steel Workers v. American Mfg. Co., 363 U.S. 564, 80 S.Ct. 1343, 4 L.Ed.2d 1403 (1960). Recently, the California Supreme Court went much further and in a "significant shift in California law toward private dispute resolution" (see App. A11), took perhaps the final step in embracing the judicial hands-off approach to arbitration awards

[7] In Haslip the punitive damages were 4 times the amount of compensatory damages. Subsequently this Court upheld an award 526 times greater than the actual damages awarded by the jury but which was still held not excessive enough in amount, where there were sufficient procedural constraints, to be deemed an arbitrary deprivation of property without due process of law. TXO Prod. Corp. v. Alliances Resources Corp., ___ U.S. ___, 113 S.Ct. 2711 (1993).

by rejecting judicial review even in the limited instance of a manifest error of law appearing on the face of the award itself and where that error causes substantial injustice. Moncharsh v. Heily & Blase, 3 Cal.4th 1, 10 Cal.Rptr.2d 183 (1992).

Whether or not one views arbitration favorably or unfavorably, it certainly has fewer, if any, safeguards against error. Arbitrators can ignore or erroneously apply the law, refuse to follow any rules of evidence, and make findings and conclusions unsupported by any evidence. Usually no record of the arbitration proceedings exists. Meaningful review of such awards by courts for errors of law or procedure is virtually impossible; and rightfully so, for any increase in judicial intervention

cuts against arbitration's critical benefits of quicker decisions and more reasonable costs. The increasing desire of overburdened courts is to provide essentially no judicial review so that the "arbitrator's decision should be the end, not the beginning of the dispute."[8]

The popular and pervasive hands-off judicial role for review of arbitration awards, however, cannot coexist with the constitutional due process requirements of Haslip. Arbitrators are free not to follow rules of evidence and they may misinterpret or misapply the law. There are simply no constraints on the arbitrator's decision, reasonable or otherwise, and no requirements for punitive damage procedures or punitive

[8] Moncharsh, supra, 3 Cal.4th at 10, 10 Cal.Rptr.2d at 187.

damage review once awarded.

At the same time as it has become next to impossible to obtain any judicial review of arbitral punitive damage awards, many states, including California,[9] are making it increasingly

[9] In a landmark decision, the California Supreme Court eliminated the availability of punitive damages for the tort of wrongful termination. See Foley v. Interactive Data Corp., 47 Cal.3d 654, 254 Cal.Rptr. 211 (1988). In Adams v. Murakami, 54 Cal.3d 105, 284 Cal.Rptr. 318 (1991), the California Supreme Court refused to uphold any punitive damage award unless evidence had been presented to the fact finder as to the wealth of the defendant. 1987 and later amendments to the California Civil Code § 3294 require a bifurcated trial with a higher evidentiary standard of "clear and convincing evidence" applicable to the punitive damage phase; for an employer to be liable for punitive damages for the acts of an employee, the employer has to have "advance knowledge" of the employee's unfitness or must have expressly "authorized or ratified" the employees' conduct. In the instant case there was no evidence ever presented to the arbitrators as to the wealth of petitioner. (C1:40).

more difficult to recover punitive damages in the courtroom. Although a few appellate courts in California have upheld this State's judicial procedures for the award of punitive damages as meeting the due process requirements of Haslip,[10] the California Supreme Court has not ruled directly on the question; however, in speaking of the Haslip decision, that Court acknowledged that with Haslip the punitive damage question "recently acquired a federal constitutional dimension" and given California's standard of punitive damage review which looks only to whether the award was the result of "passion or

[10] See, e.g., MGW, Inc. v. Fredericks Dev. Corp., 5 Cal.App.4th 92, 6 Cal.Rptr.2d 888 (1992); Las Palmas Assocs. v. Las Palmas Center Assocs., 235 Cal.App.3d 1220, 1 Cal.Rptr.2d 301 (1991).

prejudice" the California high court asked the provocative question of whether California's system might be closer, not to the Alabama system, but to the Vermont and Mississippi systems about which this Court has previously expressed its concern in prior cases.[11] The California Supreme Court concluded its discussion of Haslip by noting that "at a minimum, however, the high court has made clear a constitutional mandate for

[11] Citing Browning-Ferris, supra; and Bankers Life and Cas. Co. v. Crenshaw, 486 U.S. 71, 108 S.Ct. 1654, 100 L.Ed.2d 62 (1988); the California Supreme Court observed: "The California standard of review appears to be similar to those as to which the high court noted its concern." Adams v. Murakami, supra, 54 Cal.3d at 118 n.9, 284 Cal.Rptr. at 326 n.9. The Ninth Circuit also noted that its standard of "manifestly and grossly excessive" did not comport with due process. Searle v. Morgan, 997 F.2d 1244, 1258 (9th Cir. 1993) (citing Haslip, 111 S.Ct. at 1045 n.10).

meaningful judicial scrutiny of punitive damage awards." Adams v. Murakami, 54 Cal.3d at 118, 284 Cal.Rptr. at 326. Should it eventually be determined either by this Court (or the California Supreme Court) that California's judicial procedures are inadequate to assure punitive damages scrutiny in compliance with Haslip, the anomalous result might be that punitive damages would not be recoverable in California courts but arbitrators in this state would continue to be empowered to render wholly unreviewable punitive damage awards.

The appellate opinion in this case gave little recognition and only superficial analysis of the due process argument stating that "similar" arguments had been made and rejected in California, citing Todd Shipyards Corp. v. Cunard

Line, Ltd., 943 F.2d 1056 (9th Cir. 1991); and Baker v. Sadick, 162 Cal.App.3d 618 (1984). App. A30-33. Of course, neither of these cases dealt with Haslip at all. Baker was decided seven years before Haslip and simply stated that where the party did not have a "plain and clear" mutual understanding that punitive damages would not be awarded, the court could affirm such an award. The Todd opinion was actually issued after the Haslip decision was rendered, but Todd was briefed, argued and submitted for decision three months before Haslip, and did not reference or purport to address Haslip in any manner. In that case, defendant Cunard had made the broadest conceivable argument that the "absence of rules of evidence . . . create a substantial likelihood of an

erroneous award" and therefore violates due process.[12] Todd correctly noted that such an argument could be made to attack any arbitration award, rejecting the tired argument that all of the "formalities" or "procedural strictures" of the courtroom were necessary for due process. 943 F.2d at 1063. Thus the California Appellate Court did not offer any analysis of its own, relied on two cases that had never considered Haslip and simply fell back on the policies favoring arbitration as an alternative dispute resolution forum. App. A33-34.

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[12] This Court rejected this broad argument that arbitration denies parties due process rights to a fair hearing. Matthews v. Eldridge, 424 U.S. 319, 96 S.Ct. 893 (1976). In our case, when the appellate court referred to the fact Alexander had "notice" of a punitive damage claim (see App. A30), this did not address Haslip but only the Matthews v. Eldridge issue.

Only one federal appellate case has been located where Haslip was expressly examined in the context of judicial review of arbitration awards of punitive damages. In Lee v. Chica, 983 F.2d 883 (8th Cir.), cert. denied, 1993 U.S. Lexis 4209 (1993), the parties apparently did not argue, and thus the majority did not cite Haslip nor even consider whether the punitive damage award under the rules of the American Arbitration Association ("AAA") contravened the due process clause. However, Judge Beam, in a carefully considered dissent, analyzed the ramifications of the Supreme Court's analysis in Haslip. He noted that the arbitration agreement, which incorporated the AAA rules, nowhere mentioned punitive damages. Judge Beam observed it would be unconstitutional, absent express

authorization or consent of the parties, to interpret the arbitration agreement as empowering an arbitrator to award punitive damages:

> In the arbitration setting we have almost none of the protections that fundamental fairness and due process require for the imposition of this form of punishment. Discovery is abbreviated if available at all. The rules of evidence are employed, if at all, in a very relaxed manner. The fact finders (here the panel) operate with almost none of the controls and safeguards assumed in Haslip. Here . . . . the scope of review of the arbitrator's award is narrowly

limited if not almost nonexistent. . . . This standard of review, of course, almost completely ignores the review required by Haslip. Why should less be required in an Arbitration proceeding if, indeed, punitive damages are within the scope of AAA Rule 43? The simple answer is that

> the rules do not contemplate an award of punitive damages.

983 F.2d at 889 (Beam, dissenting).

No concept of waiver of the constitutional due process requirements in the award of punitive damages can be derived from policies favoring arbitration or from the parties' general agreement to submit their disputes to arbitration. For an effective waiver of

a constitutional right, much more is required than inference or implication--a knowing and express waiver is required. Fuentes v. Shevin, 407 U.S. 67, 94-96, 92 S.Ct. 1983, 2001-02, 32 L.Ed.2d 556 (1972). Waivers of fundamental constitutional guarantees are subject to the "most stringent scrutiny" and "courts will indulge every presumption against a finding of waiver." Bueno v. City of Donna, 714 F.2d 484, 492 (5th Cir. 1983). This standard requires an express agreement to submit a punitive damage claim to arbitration. No party can be deemed to waive due process rights without actual knowledge of such rights, a full understanding of their meaning and clear comprehension of the consequences

of any waiver.[13] Id. at 493; see also,

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[13] The Appellate Court in this case had the waiver issue backwards, arguing that it was "doubtful that [the customer] had the opportunity to negotiate any of its [the Agreement's] terms." App. A26. This is not true; also, many securities firms do not require agreements for cash accounts, so Mendez could easily have gone elsewhere without agreeing to arbitration. Furthermore, the Court noted that the customer, as "a consumer residing in Los Angeles" could not be expected to know New York law and the NASD Rules and therefore should not be held to have waived her rights to punitive damages. Id. But this is contrary to the basic idea that parties are generally free to structure their arbitration agreements as they see fit. Volt, supra, 468 U.S. at 478-79, 109 S.Ct. at 1255-56. Furthermore, imposing requirements on brokers to explain all the legal effects of choice of law is bad policy. One federal case involving a securities arbitration discussed this precise issue:

> A review of the cases that discuss the breadth of a securities broker's fiduciary obligation to the customer leads to the inescapable conclusion that the broker's duty does not require an explanation of the choice of law provision and the agreement to arbitrate.

Gouger v. Bear, Stearns & Co., 823

Wellen v. Cooper, 828 F.2d 1471, 1474 (10th Cir. 1987).

Contrary to the appellate opinion in this case, this Court has already acknowledged that Haslip clearly demands that to comport with constitutional requirements of due process, there must be meaningful judicial scrutiny of punitive damage awards. The absence of sufficiently definite and meaningful constraints upon arbitrators in the award of punitive damages runs directly contrary to the minimum procedural safeguards required in Haslip and

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F.Supp. 282, 286 (E.D. Pa 1993). The Gouger court noted strong public policy reasons against imposing a rule that brokers explain the effect of a choice-of-law provision to their customers. It was too burdensome and unrealistic to expect non-lawyer brokers to explain all the nuances of the application of New York law, only one such nuance being the inability to award punitive damages under that state's law. 823 F.Supp. at 287-88.

violates defendant's constitutional rights of due process.[14] With the pervasive trend favoring arbitration (see Moncharsh), there are basically no constraints, meaningful or otherwise, on an arbitrator's imposition of these "windfall" damages which represent a "boon" for the plaintiff "perhaps justified for societal reasons of deterrence. . . ." Adams v. Murakami, supra, 54 Cal.3d at 120, 284 Cal.Rptr. at

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[14] There is uncertainty over whether ample pre-judgment constraints can make up for infirmities in post-judgment review; although not important to this case where there are no constraints on arbitrators at any point in the process, such uncertainty may be resolved as a result of this Court's grant of certiorari on January 14, 1994, in Oberg v. Honda Motor Co., 316 Ore. 263, 851 P.2d 1084 (1993).

327.[15] Combining meaningful judicial scrutiny and judicial hands-off policies is like mixing gasoline and water. It cannot be done. Without a party's express agreement or consent to an award of punitive damages, such an unreviewable award violates fundamental rights to due process of law. Petitioner is entitled to correction of the award to strike only the portion relating to punitive damages.

II. THE DECISION BELOW THAT AS TO THE ISSUE OF PUNITIVE DAMAGES FEDERAL SUBSTANTIVE LAW WAS APPLICABLE AND THUS THE PARTIES' CHOICE OF NEW YORK

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[15] Scholars have suggested that fairness requires that any punitive damage award go to the state and not to individual litigants. See, e.g., E. Jeffrey Grube, Punitive Damages: A Misplaced Remedy, 66 U.S.C. L. REV. 839 (1993).

LAW COULD BE IGNORED UNDER THE DOCTRINE OF PREEMPTION [FEDERAL ARBITRATION ACT], ALTHOUGH SUPPORTED BY SOME CIRCUIT COURTS, CONFLICTS WITH DECISIONS OF THE SECOND CIRCUIT AND WITH SOUND LOGIC.

Petitioner asserted the parties' choice of law agreement as a separate and independent ground for its petition for correction to strike the punitive damage award. (C1:11, 23-26). The customer's Cash Agreement contained, in addition to the arbitration provisions, a clause that provided, "This Agreement and its enforcement shall be governed by the laws of the State of New York." (C1:13).

The California Appellate Court never questioned petitioner's citation of New York law: that Court agreed that under New York law arbitrators have no power to

award punitive damages. Indeed such damages are not a private compensatory remedy and thus if awarded by arbitrators, such an award is violative of public policy. The leading case in New York is Garrity v. Lyle Stuart, Inc., 40 N.Y.2d 1354, 353 N.E.2d 793 (Ct. of App. 1976) (C1:30). Garrity based its holding on policy grounds remarkably similar to the constitutional concerns expressed in Haslip. The Garrity Court quoted the following from a prior decision with approval:

> "The trouble with an arbitration[sic] admitting a power to grant unlimited damages by way of punishment is that if the court treated such an award in the way arbitration awards are usually treated, and

followed the award to the letter, it would amount to an unlimited draft upon judicial power. In the usual case, the court stops only to inquire if the award is authorized by the contract; is complete and final on its face; and if the proceeding was fairly conducted.

"Actual damage is measurable against some objective standard--the number of pounds, or days, or gallons or yards; but punitive damages take their shape from the subjective criteria involved in attitudes toward correction and reform, and courts do not accept readily the delegation

of that kind of power. Where punitive damages have been allowed for those torts which are still regarded somewhat as public penal wrongs as well as actionable private wrongs, they have had rather close judicial supervision. If the usual rules were followed there would be no effective judicial supervision over punitive awards in arbitration." 353 N.E.2d at 796 (C1:33).

The New York court noted that imposing penal sanctions in private arrangements violates the rule of law requiring that the use of coercion and the imposition of social sanctions must be reserved to the state, through its

courts and juries.[16] New York cases continue to uphold Garrity.[17]

The choice of law provision, specifying New York law, controls. Here there are some minimum contacts with New York.[18] However, even if there was not,

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[16] Other states deny arbitrators the power to award punitive damages; these include Colorado, Minnesota, Nebraska, New Mexico, New Hampshire.

[17] See, e.g., Belco Petroleum Corp. v. AIG Oil Rig, Inc., 565 N.Y.S.2d 776, 784 (1st Dep't 1991); see also Fahnestock, infra.

[18] Although Petitioner Alexander is a small California broker-dealer, it is a member of the NASD which itself is headquartered in New York; Claimant Mendez's trades were mostly executed on the New York Stock Exchange; and all transactions in Claimant Mendez's account were cleared through Pershing, a division of Donaldson Lufkin & Jenrette Securities Corp., headquartered in New York. This formed the basis for the California Appellate Court's determination that the Cash Account Agreement evidenced a transaction in "interstate commerce."

the choice of law provision is enforceable. Parties can agree on a choice of law, even when there is no relationship to the state specified to the contract. As Professor Witkin has stated: "If the parties have designated the law of a particular state, the court will apply that law, even though the state has no relationship to the contract." 1 WITKIN, SUMMARY OF CAL. LAW, Contracts, § 63, p. 100 (9th ed. 1987); accord RESTATEMENT SECOND, Conflict of Laws, § 204.

Here it is undisputed that the parties expressly agreed to the application of New York law. New York law emphatically denies arbitrators the power to award punitive damages and no good reason exists for refusing to

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App. A13.

enforce the parties' agreement. Even if this case had come up through the federal courts under the FAA, state law would be applicable either because of the parties' express agreement or pursuant to accepted principles of diversity. The reason for this was explained by this Court in Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1982):

> "The arbitration agreement . . . creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate, yet it does not create any independent, federal-question jurisdiction. . . . hence, there must be diversity of citizenship or some other independent basis for federal jurisdiction before the order can issue." 460 U.S. at 25, n.32,

103 S.Ct. at 942, n.32.

In this case the California Appellate Court ignored the parties' agreement and settled principles of choice of law by asserting that the issue of whether arbitrators can award punitive damages is part of a body of "federal substantive law." Other than general statements about the purpose and effect of the FAA to encourage arbitration of civil disputes and to resolve the doubts concerning the scope of arbitrable issues in favor of arbitration as emphasized by this Court in Southland Corp. v. Keating, 465 U.S. 1, 10-12, 104 S.Ct. 852, 859, 79 L.Ed.2d 1, 13 (1984); or in Moses H. Cone, supra, 460 U.S. at 24-25, the authority for this proposition is found in Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378, 1387 (11th Cir. 1988).

In Bonar the parties' agreement provided for arbitration under the AAA Commercial Arbitration Rules and also contained a New York choice-of-law provision. Judge Kravitch held that AAA Rule 43, providing that an "arbitrator may grant any remedy or relief which he deems just and equitable and within the scope of the agreement of the parties," [emphasis added] authorized the arbitrators to award punitive damages in the absence of a choice-of-law provision; but then after acknowledging that the Garrity rule in New York prohibited arbitrators from awarding punitive damages, Judge Kravitch concluded that the addition of the choice-of-law provision did not deprive the arbitrators of that power: "Thus, a choice-of-law provision in a contract governed by the

Arbitration Act merely designates the substantive law that the arbitrators must apply in determining whether the conduct of the parties warrants an award of punitive damage; it does not deprive the arbitrators of their authority to award punitive damages." 835 F.2d at 1387.

In subsequent cases under the rules of the AAA, Bonar has been followed by the 1st and 9th Circuits. Raytheon Co. v. Automated Business Sys., Inc., 882 F.2d 6 (1st Cir. 1989); Todd Shipyards Corp. v. Cunard Line, Ltd., supra; cf. Howard P. Foley Co. v. International Bhd. of Elec. Workers, Local 639, 789 F.2d 1421 (9th Cir. 1986) (arbitrators lack power to award punitive damages in labor disputes absent an express provision in the contract).

The preemption issue was carefully

analyzed by the 2nd Circuit in Fahnestock & Co. v. Waltman, 935 F.2d 512 (2nd Cir. 1991). Judge Miner in Fahnestock approved a New York Stock Exchange ("NYSE") arbitration award of compensatory damages but reversed the award of punitive damages on the basis of Garrity and the normal application of New York law in a diversity case. As stated by this Court, the general rule in diversity cases is that where "state law provides the basis for decision, the propriety of an award of punitive damages for the conduct in question" is a matter of state law. Browning-Ferris, supra, 492 U.S. at 278, 109 S.Ct. at 2922. Further, as this Court held in Volt Info. Sciences v. Board of Trustees of Leland Stanford Jr. Univ., 489 U.S. 468, 477, 109 S.Ct. 1248, 1254, 103 L.Ed.2d 48,

(1989), "The FAA contains no express preemptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration." This Court in Volt permitted the application of state law in arbitration matters, subject to a narrow reading of preemption only in those cases where "it actually conflicts with federal law." Id.

The concept of federal preemption under the FAA was developed in response to state laws that restrict arbitration in derogation of agreements freely negotiated. See, e.g., Perry v. Thomas, 482 U.S. 483, 489-90, 107 S.Ct. 2520, 2525-26, 96 L.Ed.2d 426 (1987). Fahnestock concluded with this analysis:

> [S]tate law relating to the propriety of a punitive damages award in the absence of an

agreement on the subject is not preempted by any federal substantive law bearing on the subject.

. . .

It follows that in this action the Garrity rule prohibiting the award of punitive damages by arbitration must be applied. That the rule is grounded in state policy concerns renders it no less a rule of substantive law. 935 F.2d at 518.

Fahnestock was soon followed by the 2nd Circuit opinion in Barbier v. Shearson Lehman Hutton, Inc., 948 F.2d 117 (2nd Cir. 1991) which involved an NYSE arbitration award of both compensatory and punitive damages where the parties had an express choice-of-law provision in their contract. The court

held that, "The Barbiers contend that the choice-of-law clause incorporates only state substantive law, and not state arbitration law. Like the district court, they characterize Garrity as arbitration law rather than substantive law. We already have held that the measure of damages is a matter of state substantive law, see Fahnestock. . . . " 948 F.2d at 122.[19]

Although Fahnestock and Barbier appear to be by far the better reasoned cases on the federal preemption issue, there is another way to explain Bonar and

[19] Ironically, the California appellate decision after making an argument for the preemption of federal substantive law, rejects Fahnestock and Barbier on the sole ground that they are "in direct contravention of the prevailing policy in California" citing two cases in California which upheld arbitration awards of punitive damages. See App. A23.

its progeny by concluding there is no genuine conflict between Fahnestock and Bonar. As noted above, Bonar, Raytheon and Todd Shipyards, supra, all relied heavily on the broad language in AAA Rule 43 concerning the arbitrators' authority to fashion "any remedy or relief" deemed "just and equitable."[20] Although there is not the slightest reference even in the AAA Rules to punitive damages, there is at least the weak argument that these vague and broad words such as "remedy" somehow support the conclusion that agreeing to arbitration under the AAA constitutes agreement or consent to an

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[20] In California, this same broad language in AAA Rule 43 was rejected as authority for allowing a party to recover attorneys' fees where such fees were not expressly agreed in the parties' contract. See Thompson v. Jesperson, 222 Cal.App.3d 964, 272 Cal.Rptr. 132 (1990); and see Collins v. Luster, infra.

award of punitive damages.[21]

Moreover, and more importantly, the arbitration in the instant action was one under the auspices of the NASD and not under the AAA. The NASD Arbitration Rules do not mention punitive damages, nor do they even contain any vague rules relating to remedies such as contained in

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[21] Textbooks often categorize punitive damages as a type of legal "remedy." The fallacy of this is that the most widely accepted justification for punitive damages is deterrence, not compensation. For purposes of deterrence, punitive damages are not really a remedy at all; their design is prospective, not retrospective. If they do serve as a remedy, they remedy harm to society as a whole, not harm to civil plaintiffs who are otherwise compensated to the extent society chooses to compensate them. When paid to civil plaintiffs, punitive damages are a windfall and are to that extent "misplaced." Grube, supra at 880.

AAA Rule 43. Notably, the Fahnestock and Barbier cases, supra, which the Appellate Court here flatly refused to follow, involved NYSE arbitrations where the rules are substantially similar to the NASD rules; neither the NYSE or NASD has any provision remotely comparable to AAA Rule 43. "[T]he NYSE Rules have no provisions relating to remedy or relief. Clearly, if the NYSE wanted to empower arbitrators to award punitive damages it could have done so." Fahnestock, supra, 935 F.2d at 519. Finally, the cases relying on AAA Rule 43 to justify arbitration awards of punitive damages simply ignore the second part of the rule stating that any remedy or relief, must be "within the scope of the agreement of the parties."

III. IN ADDITION TO DUE PROCESS AND PREEMPTION CONCERNS, SOUND CONTRACT LAW AND PUBLIC POLICY SUGGEST THAT THE DRASTIC SANCTION OF PUNITIVE DAMAGES, WHICH EMBODIES THE DUAL SOCIETAL GOALS OF PUNISHMENT AND DETERRENCE, SHOULD ONLY BE PERMITTED TO BE IMPOSED IN ARBITRATION WITH THE EXPRESS AGREEMENT OF THE PARTIES.

Certainly it is clear that petitioner intended and expected Garrity to apply and that the arbitrators would not have the power to award punitive damages. As noted in Barbier, supra, "We need not look to the Fahnestock rationale to determine whether Garrity should be applied here, because the language of the parties' Agreement is clear: 'This Agreement shall . . . be governed by the

laws of the State of New York.'" 948 F.2d at 122. Further, the laws of New York or California or the intent and purpose of the FAA itself all require that private agreements to arbitrate be enforced in accordance with their terms. Even in Bonar, Circuit Judge Tjoflat stated in a concurring opinion,

> I can understand how, in an appropriate case, an arbitrator may find that an award of punitive damages would be 'just and equitable.' I have difficulty, however, understanding how punitive damages can ever be considered 'within the scope of the agreement of the parties' absent some express provision in the contract.' 835 F.2d at

1388.

Although arbitrators should have flexibility to fashion appropriate remedies upon the submission of contractual and other disputes to arbitration, the scope of such remedies should be limited to making any injured party whole and,

> Whether that scope can fairly be said to encompass the assessment of a penalty for wilful or wanton misconduct, however, is extremely doubtful. Punitive damages are designed to serve the societal functions of punishment and deterrence; unlike contract remedies, they are not designed to vindicate the parties' contractual bargain. Consequently, absent

> an express provision in the contract, punitive damages should be considered as outside the scope of the parties' agreement and beyond the power of the arbitrator to award. Id. at 1389.[22]

Even in the California Supreme Court's recent Moncharsh decision, reflecting the extreme reluctance of courts to interfere with arbitration awards even where there is manifest error on the face of the award which could result in substantial injustice, the court was very careful to note that "Moncharsh does not argue that the arbitrator's award strayed beyond the

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[22] These same thoughts were echoed by Judge Beam in his dissenting opinion in Lee v. Chica quoted in Part I above.

scope of the parties' agreement by resolving issues the parties did not agree to arbitrate."[23] In the instant case, the NASD arbitrators clearly strayed beyond the parties' agreement and as noted by the California Appellate Court, "A review of the Cash Account Agreement reveals that appellant is correct; there is nothing contained therein which either expressly includes or excludes awards of punitive damages." App. A17.

On the merits of its dispute with its customer, petitioner Alexander had substantial factual and legal arguments that it was not liable for any compensatory damages or that such damages were excessive; however, the decision in

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[23] Moncharsh, supra, 3 Cal.4th at 28, 10 Cal.Rptr.2d at 200.

that regard and the amounts the arbitrators determined were sufficient to make the claimant whole were clearly within the intended scope of the arbitration agreement and thus were not, and are not here, challenged. These issues were precisely those expected to be resolved by the arbitrators, falling squarely within the four corners of the arbitration agreement. The compensatory damages awarded recouped for the customer every dollar the arbitrators believed was lost as a result of any conduct by petitioner and its broker. However, punitive damages, which encompass societal goals of punishment and deterrence, go well beyond the merits of the dispute and do not constitute an issue the parties agreed to arbitrate. The difficult case on the issue of FAA

preemption will come where the parties have agreed on the application of New York law, including Garrity, but where the parties also have expressly agreed to a potential punitive damage award. See Fahnestock, supra, 935 F.2d at 518. This is not such a case. There was no agreement on punitive damages, period. Because arbitration is strictly a creature of contract, any award of punitive damages by an arbitrator, when not agreed to or consented to by the party against whom they are imposed, results in the arbitrator exceeding his powers under the agreement.

IV. CONCLUSION

The unfettered and unreviewable discretion of arbitrators to award punitive damages violates petitioner's

constitutional rights to due process as enunciated by Haslip. How can we allow arbitrators in California to mete out standardless unreviewable awards of punitive damages to punish and deter while courts and juries in this State are precluded by due process constraints from awarding such damages absent bifurcated separate proceedings, a greater burden of proof by clear and convincing evidence, and heightened scrutiny and review at every stage of the judicial process?[24]

The award of punitive damages in this case by the NASD arbitrators went far

[24] Indeed, as noted above, if the California Supreme Court determines that California's judicial process does not pass constitutional muster under Haslip, we could have the anomalous result that punitive damages would not be recoverable at all in California courts but arbitrators in this State could continue to render standardless and unreviewable punitive damage awards.

beyond the scope of the parties' basic agreement to submit the controversy for resolution to arbitration, went beyond any rules or powers delegated to the arbitrators by the NASD, and flew in the face of an express choice of law provision agreed to by the parties providing for the application of New York law which precludes arbitrators awarding punitive damages.

The California Court of Appeal purported to base much of its decision on general policy arguments favoring arbitration as an alternative dispute resolution forum (App. A33); it is most important to note that requiring that the parties expressly agree to the drastic sanction of punitive damages is not inconsistent with this general policy. In a recent California case, an

arbitrator had granted certain equitable relief pursuant to express agreement of the parties; but when his injunctive awards were ignored and he imposed monetary sanctions to enforce compliance, the court held that the arbitrator exceeded his powers because nothing in the arbitration agreement expressly authorized such sanctions. Collins v. Luster, 15 Cal.App.4th 1338, 19 Cal.Rptr.2d 215 (1993). Although a court would have had inherent power to enter such an order, the Luster court refused to "infer" such power despite the broad nature of the submission. A key advantage to arbitration is that parties have always been allowed to structure their agreements as they see fit (Volt, supra, 468 U.S. at 478-79, 109 S.Ct. 1255-56); it is wholly consistent with

that policy that arbitrators be allowed to enforce only such significant remedial powers to which the parties have clearly and expressly agreed. This is sound policy even if this Court had not held that "unlimited judicial discretion [let alone unlimited arbitral discretion] . . . in the fixing of punitive damages may invite extreme results that jar one's constitutional sensibilities." Haslip, supra, 111 S.Ct. at 1043.

This Court should resolve this constitutional question of first impression, and of nationwide importance to the increasing use of arbitration as an alternative to our overburdened courts, by holding that arbitrators cannot constitutionally award punitive damages without the express agreement of the parties. Such a decision will not

discourage alternative dispute resolution nor will it impact at all any arbitration awards compensating injured parties for ~~all~~ loss and damage suffered.

Further, should this Court determine that any conflict exists between the Federal Courts of Appeals on the preemptive effect of the FAA as it relates to the remedy of punitive damages, such conflict should be resolved by this Court.

Pursuant to Rules of this Court, petitioner Alexander respectfully prays that a writ of certiorari should issue to review the opinion of the California Appellate Court for the Second Appellate District.

Respectfully submitted,

GRAVEN PERRY BLOCK BRODY & QUALLS
a Professional Corporation

By _____
Ralph B. Perry III,
Attorneys for Petitioner
J. Alexander Securities, Inc.

APPENDIX A

OPINION OF THE CALIFORNIA
COURT OF APPEAL FOR THE
SECOND APPELLATE DISTRICT

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION TWO

J. ALEXANDER SECURITIES, INC. Petitioner and Appellant, v. SIGNE MENDEZ, Respondent.	)	B070514 (Super. Ct. No. BS015860) FILED AUG 9, 1993

Appeal from a judgment of the Superior Court of Los Angeles County. Charles C. Lee, Judge. Affirmed.

Graven Perry Block Brody & Qualls, and Ralph B. Perry III, for Petitioner and Appellant.

Ross and Scott, and Diana P. Scott, for Respondent.

J. Alexander Securities, Inc. appeals from the judgment entered against it following the trial court's denial of a motion to correct an arbitration award that included punitive damages. We affirm the judgment.

FACTS & PROCEDURAL HISTORY

In 1980, respondent Signe Mendez, an elderly widow, opened a securities account with appellant J. Alexander Securities, Inc., a brokerage firm in Los Angeles. Respondent executed an agreement regarding payment for securities purchased on her behalf, entitled "Cash Account Agreement." The Cash Account Agreement provided, inter alia, that, "[t]his agreement and its enforcement shall be governed by the laws

of the State of New York . . . . "[1] The Cash Account Agreement also contained a clause providing for arbitration of "any dispute or controversy between [appellant and respondent] arising under any provision of the federal securities laws" and "all other disputes or controversies between us arising out of [appellant's] business or this agreement."[2]

[1] Appellant is a member of the National Association of Securities Dealers which is headquartered in New York. According to appellant, the majority of the trades made on respondent's behalf were executed on the New York Stock Exchange, and all transactions in her account with appellant were cleared through a corporation headquartered in New York.

[2] The arbitration provisions read in full: "ANY DISPUTE OR CONTROVERSY BETWEEN US ARISING UNDER ANY PROVISION OF THE FEDERAL SECURITIES LAWS CAN BE RESOLVED THROUGH LITIGATION IN THE COURTS IF THE UNDERSIGNED SO CHOOSES. THE UNDERSIGNED ALSO UNDERSTANDS THAT ARBITRATION IS AVAILABLE WITH RESPECT TO

In 1991, a dispute arose in which respondent alleged that appellant and Andrew Weber, an account manager employed by appellant, had engaged in securities fraud, deceptive practices, account churning and unauthorized and unsuitable stock trades, resulting in substantial financial losses to respondent. The parties, without objection, submitted their dispute to arbitration before a National Association of Securities Dealers (NASD) panel of three

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SUCH DISPUTES. Additionally, all other disputes or controversies between us arising out of your business or this agreement, shall be submitted to arbitration conducted under the provisions of the Constitution and Rules [of] the Board of Governors of the New York Stock Exchange, Inc., or pursuant to the Code of Arbitration Procedures of the National Association Of Securities Dealers, Inc., as the undersigned may elect. . . ."

arbitrators.[3] In January 1992, hearings on the controversy were conducted before the panel in Los Angeles. It is undisputed that the issue of punitive damages was submitted to the arbitrators.[4] On March 10, 1992, the

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[3] According to appellant, only one of the arbitrators was connected with the securities industry, and the other two were "public" arbitrators, in accordance with NASD rules. The rules provide for selection of the panel by the NASD Director of Arbitration, and the parties then have the opportunity to exercise unlimited challenges for cause and one peremptory challenge.

[4] Respondent requested that we take judicial notice of her statement of claim presented to the panel and appellant's answer. We deferred ruling on this request pending consideration of this appeal. We have granted the request (Jonas v. Kvistad (1971) 19 Cal.App.3d 836, 842; National Automobile & Cas. Ins. Co. v. Payne (1986) 261 Cal.App.2d 403, 408; Code Civ. Proc., § 909) but in doing so, do not purport to review the merits of the arbitrators' decision. (Cf. City of Oakland v. United Public Employees (1986) 179 Cal.App.3d 356, 366, fn. 3.)

panel awarded respondent $27,000 in compensatory damages, for which appellant and Weber were held jointly liable, and $27,000 in punitive damages against appellant only, for the "failure to meet its duty and obligation to adequately supervise Andrew E. Weber, in that it did not come up to the standard of supervision required to assure compliance with applicable securities regulations."

In April 1992, appellant moved to correct the arbitration award pursuant to Code of Civil Procedure section 1286.6, on the ground that the arbitrators had exceeded their powers by awarding punitive damages. It contended that pursuant to the Cash Account Agreement, the arbitrators were bound by New York law, and that New York law prohibits arbitrators from awarding punitive

damages. Respondent opposed the motion on the grounds that (1) the Cash Account Agreement was not the subject of the arbitration, and thus, its provisions did not apply; (2) there was no agreement to apply New York law, and in fact, the arbitrators did not apply New York law; (3) even if there had been an agreement that New York law applied, the matter of punitive damages was a procedural issue, which was governed by NASD rules and California law, and would not be affected by New York law; and (4) the award of punitive damages did not violate due process principles because appellant and Weber knew that respondent was seeking punitive damages, and litigated that issue in the arbitration.

The court denied the motion to correct the award, and confirmed the

award "on the grounds set forth in the opposition papers." Judgment was entered accordingly.

CONTENTIONS ON APPEAL

Appellant contends the trial court erred in denying its motion to correct the award and vacate the punitive damages because (1) the parties never agreed to grant the arbitrators the power to award punitive damages, (2) the arbitrators exceeded their powers by awarding punitive damages since they were bound by New York law, and (3) the award of punitive damages resulted in a denial of due process.

Respondent requests sanctions against appellant for the filing of a frivolous appeal. (Code Civ. Proc., § 907.)

DISCUSSION

Code of Civil Procedure section 1286.6 provides that an arbitration award shall be corrected if "(a) [t]here was an evident miscalculation of figures or an evidence mistake in the description of any person, thing or property referred to in the award; [¶] (b) The arbitrators exceeded their powers but the award may be corrected without affecting the merits of the decision upon the controversy submitted; or [¶] (c) The award is imperfect in a matter of form, not affecting the merits of the controversy."

Code of Civil Procedure section 1286.2 provides five specific grounds under which a court can vacate an arbitration award: (1) if the award was procured by corruption, fraud, or other undue means; (2) if any of the

arbitrators was corrupt; (3) if the rights of a party were substantially prejudiced by the misconduct of an arbitrator; (4) if the arbitrators exceeded their powers and the award cannot be correct without affecting the merits of the decision upon the controversy submitted; or (5) the rights of a party were substantially prejudiced by the refusal of the arbitrators to postpone the hearing upon a showing of sufficient cause, to hear material evidence, or by any other conduct.

These statutes provide the exclusive grounds upon which a court may review private arbitration awards. (Moncharsh v. Heily & Blase (1992) 3 Cal.4th 1, 26-28.) Judicial review of arbitration awards is limited to these specific and narrow statutory grounds, since "by

voluntarily submitting to arbitration, the parties have agreed to bear [the risk of an erroneous decision by the arbitrator] in return for a quick, inexpensive, and conclusive resolution to their dispute." (Id. at pp. 11-12.)

The recently-decided Moncharsh case represents a significant shift in California law towards private dispute resolution. The clear impact of that case is to allow parties the latitude to select their method of dispute resolution and to promote judicial restraint from interfering with that process and the resulting judgment unless there are extremely egregious circumstances surrounding the method of resolution.

Appellant contends that the award must be corrected pursuant to Code of Civil Procedure section 1286.6,

subdivision (b), because the arbitrators exceeded their powers and that the award can be corrected merely by striking the punitive damages portion of the award.

(1) The Arbitrators Did Not Exceed Their Powers in Awarding Punitive Damages

A. The Arbitrators Were Not Precluded From Awarding Punitive Damages by Virtue of the New York Law Provision.

The parties do not dispute that under New York law, arbitrators have no authority to award punitive damages. (Garrity v. Lyle Stuart, Inc. (1976) 40 N.Y.2d 354 [386 N.Y.S.2d 831; 353 N.E.2d 793].) Assuming that the Cash Account Agreement governed the dispute submitted

to arbitration,[5] and that pursuant to it the parties agreed that the arbitrators were to apply New York law in resolving the dispute, the choice of law provision does not compel us to vacate the award of punitive damages.[6]

Because the Cash Account Agreement "evidenced a transaction in interstate commerce," the Federal Arbitration Act (FAA) applies. (9 U.S.C. § 2; Bonar v. Dean Witter Reynolds, Inc. (11th Cir.

[5] Respondent claims that the Cash Account Agreement did not constitute the entire agreement between the parties, and was merely an exhibit introduced at the arbitration proceedings to establish appellant's lack of discretion in stock purchases. However, there is no indication from the record what comprised the "entire agreement" between the parties.

[6] The parties concede that the New York prohibition on punitives was not argued in the arbitration proceedings.

1988) 835 F.2d 1378, 1387; Raytheon Co. v. Automated Business Systems, Inc. (1st Cir. 1989) 882 F.2d 6, 9.) The purpose and effect of the FAA is to encourage arbitration of civil disputes outside the judicial forum. (Southland Corp. v. Keating (1984) 465 U.S. 1, 10-11, [79 L.Ed.2d 1, 13; 104 S.Ct. 852, 859]; Moses H. Cone Hospital v. Mercury Constr. Corp. (1983) 460 U.S. 1, 22 [74 L.Ed.2d 765; 103 S.Ct. 927, 941-942].) The FAA creates a body of federal substantive law which governs the question of arbitrability in both state and federal courts. (Southland Corp. v. Keating, supra, at p. 12; Moses H. Cone Hospital v. Mercury Constr. Corp., supra, at p. 24; Todd Shipyards Corp. v. Cunard Line, Ltd. (9th Cir. 1991) 943 F.2d 1056, 1062.) The overriding principle

underlying the FAA is that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration". (Moses H. Cone Hospital v. Mercury Constr. Corp., supra, at pp. 24-25.) Federal policy supports vesting arbitrators with the authority to award punitive damages if the parties' agreement contemplates such an award. (Todd Shipyards Corp. v. Cunard Line, Ltd., supra, at pp. 1062-63; Bonar v. Dean Witter Reynolds, Inc., supra, at p. 1387; Raytheon Co. v. Automated Business Systems, Inc., supra, at pp. 11-12; Willoughby Roofing & Supply v. Kajima Intern. (N.D. Ala. 1984) 598 F.Supp. 353, 360, aff'd in (11th Cir. 1985) 776 F.2d

269.)[7] The choice of law provision, therefore, merely designates the substantive law that the arbitrators must apply in determining whether the conduct of the parties warrants an award of punitive damages; it does not deprive the arbitrators of their authority to award punitive damages. (Bonar v. Dean Witter Reynolds, Inc., supra, at p. 1387; Willoughby Roofing & Supply v. Kajima, Intern., supra, at p. 359, Raytheon Co. v. Automated Business Systems, Inc., supra, at p. 11, fn. 5, Willis v.

[7] We decline to follow two Second Circuit cases, Barbier v. Shearson Lehman Hutton Inc. (2nd Cir. 1991) 948 F.2d 117, 122 and Fahnestock & Co. v. Waltman (2nd Cir. 1991) 935 F.2d 512, 518, which held, contrary to the cases cited above, that state law relating to the propriety of a punitive damages award by an arbitrator is not preempted by federal substantive law, and thus vacated the punitive damage awards. (See further discussion of these cases, infra.)

Shearson/American Express, Inc. (M.D. N.C. 1983) 569 F.Supp. 821, 824; Singer v. E.F. Hutton & Co., Inc. (S.D. Fla. 1988) 699 F.Supp. 276, 279.)

B. The Agreement Contemplated the Award of Punitive Damages.

Appellant contends that even apart from the choice of law provision, there was nothing in the parties' agreement which indicated that punitive damages were contemplated. A review of the Cash Account Agreement reveals that appellant is correct; there is nothing contained therein which either expressly includes or excludes awards of punitive damages.

It is undisputed that the agreement of the parties controls the scope of the arbitrators' authority. (See United Steelworkers v. Enterprise Corp. (4th

Cir. 1960) 363 U.S. 593, 597; Totem Marine Tug & Barge v. North Am. Towing, Inc. (5th Cir. 1979) 607 F.2d 649, 651.) Here, the agreement to arbitrate contained in the Cash Account Agreement encompassed "any dispute or controversy between [the parties] arising under any provision of the Federal securities laws" and "all other disputes or controversies between [the parties] arising out of [appellant's] business or this agreement." These clauses clearly seem to contemplate a wide range of tort and contract claims. Moreover, clauses similar to these have been held sufficiently broad to encompass awards of punitive damages. (See e.g., Raytheon Co. v. Automated Business Systems, Inc., supra, 882 F.2d at pp. 7, 10-12 ["[a]ll disputes arising in connection with the

Agreement shall be settled by arbitration . . . ."]; Willoughby Roofing & Supply v. Kajima Intern., supra, at pp. 355, 358 ["[a]ll claims, disputes, and other matters in question arising out of, or relating to, this Agreement or Work Assignment or the breach thereof . . . shall be resolved by arbitration . . . ."]; Willis v. Shearson/American Express, Inc., supra, at pp. 822-823 ["any controversy arising out of or relating to my accounts, the transactions with you or me or to this agreement or the breach thereof, shall be settled by arbitration . . . ."].) We likewise hold that the arbitration provisions in the Cash Account Agreement contemplated punitive damages.

Appellant further argues that because the Cash Account Agreement also

provides that the arbitration be conducted in accordance with New York Stock Exchange (NYSE) Rules or the Code of Arbitration Procedures of the NASD, which are silent on the issue of punitive damages, such an award was not contemplated by the parties. Appellant distinguishes Todd Shipyards Corp. v. Cunard Line, Ltd., supra, 943 F.2d 1056 and Bonar v. Dean Witter Reynolds, Inc., supra, 835 F.2d 1378, cases which upheld punitive damage awards by arbitrators despite New York choice of law provisions, on the grounds that those cases involved arbitration agreements which incorporated the rules of the American Arbitration Association (AAA) instead of NASD rules. The AAA rules provide that the arbitrator may "grant any remedy or relief which is just and

equitable and within the terms of the agreement of the parties." (Emphasis added.) Appellant contends that because this arbitration was conducted under the auspices of the NYSE and NASD and not pursuant to the AAA, an award of punitive damages was not contemplated by the agreement, citing Fahnestock and Co., Inc. v. Waltman, supra, 935 F.2d 512.

In Fahnestock, the arbitration agreement incorporated the NYSE arbitration rules which do not have any provisions relating to remedies or relief. The Second Circuit held that those rules did not contemplate punitive damage awards despite the fact that the NYSE award form contains a specific

section for punitives.[8] We do not find, given the overwhelming policy favoring arbitrability enunciated by other federal circuits, that the NASD's failure to specifically address the issue of damages in its arbitration rules manual expressly precluded the arbitrators here from awarding punitive damages. (See Shearson/American Express, Inc. v. McMahon (1987) 482 U.S. 220 [107 S.Ct. 2332, 96 L.Ed.2d 185], holding that RICO claims, including those seeking treble

[8] The court in Fahnestock, however, noted that while no choice of law provision was contained in the agreement to arbitrate, New York law applied because diversity was the basis for subject matter jurisdiction, and that "NYSE arbitrations occur throughout the nation, and our holding here does not mean that in those states in which arbitral punitive damages awards are permitted, arbitrators may not appropriately utilize the punitive damages section of the award form." (Id. at p. 519.)

damage awards, are arbitrable under the FAA.)

Another Second Circuit case, Barbier v. Shearson Lehman Hutton Inc., supra, 948 F.2d 117, reversed an order confirming a punitive damages award despite a New York choice of law provision in the parties' agreement to arbitrate. The court found that the measure of damages is a matter of state substantive law and that the choice of law provision reflected the agreement and the intention of the parties, and thus, it was merely enforcing the terms of their agreement by voiding the punitive damage award. (Id. at p. 122.)

The results in Fahnestock and Barbier are in direct contravention to the prevailing policy in California. Two California cases have dealt squarely with

the issue of an arbitrator's authority to award punitive damages. In Baker v. Sadick (1984) 162 Cal.App.3d 618, a patient about to undergo surgery signed an agreement which provided that "any dispute as to medical malpractice . . . will be determined by submission to arbitration." A panel of arbitrators awarded the patient punitive damages in conjunction with her medical malpractice claim. On appeal from an order confirming that portion of the award, the Fourth District found, inter alia, that the agreement did not preclude a punitive damage award since the parties did not have a "plain and clear" mutual understanding that punitive damages would not be awarded, and that state public policy favored arbitration of medical malpractice claims. (Id. at pp. 626,

630.) In a later decision, Tate v. Saratoga Savings & Loan Assn. (1989) 216 Cal.App.3d 843, an appeals court found that while an arbitration clause which provided for arbitration of "any controversy aris[ing] between the parties concerning this Joint Venture, construction of said project, or the rights and duties of any party under this Agreement," did not specifically allow for punitive damages, it was not irrational to conclude that the parties contemplated the possibility of punitive damages and that the arbitrators did not act in excess of their powers in awarding punitives. (Id. at p. 855.) Based on the absence of any express clause in the Cash Account Agreement or in the NASD rules prohibiting an award of punitive damages, we cannot say the arbitrators

acted in excess of their powers.

Furthermore, any suggestion that respondent waived her right to punitive damages by signing the Cash Account Agreement is wholly without merit. Respondent was obviously required to sign the document as a prerequisite to doing business with appellant and it is doubtful she had the opportunity to negotiate any of its terms. The Cash Account Agreement does not explicitly address the issue of punitives, nor should respondent, a consumer residing in Los Angeles, have been expected to know the applicable provisions of New York law or the NASD rules concerning punitive damages.[9] Without a voluntary and

[9] Indeed, appellant contended in both the trial court and on appeal, that the sole reason for incorporating a New York law provision was to preclude punitive

intentional relinquishment of a known right, respondent cannot be deemed to have waived her right to punitive damages. (Bonar v. Dean Witter Reynolds, Inc., supra, 835 F.2d at pp. 1387-1388; Raytheon Co. v. Automated Business Systems, Inc., supra, 882 F.2d at pp. 11-12.)

Moreover, it is a standard principle of contract interpretation that ambiguities be resolved against the drafter. (Steven v. Fidelity & Casualty Co. (1962) 58 Cal.2d 862, 882-884; see Rest. 2d Contracts (1981) § 206 pp. 105-106; 4 Williston on Contracts (3d ed. 1961) § 621, pp. 760-774.) Appellant drafted the Cash Account Agreement and

damage awards. It, however, did not see fit to spell out that reason in plain language in the Cash Account Agreement, but instead disguised it.

was perfectly capable of including an express exclusion of the availability of punitive damages but did not do so. (Raytheon, supra, at p. 12.) In the absence of an express exclusion, however, we will not automatically assign such a prohibition to their agreement. (Willoughby Roofing & Supply v. Kajima Intern., supra, 598 F.Supp. 353, 358; Ehrich v. A.G. Edwards & Sons, Inc. (D. S.D. 1987) 675 F.Supp. 559, 564; Baker v. Sadick, supra, 162 Cal.App.3d 618, 626.)

In view of our holding, we need not reach the question as to whether the award can be corrected by simply striking the punitive damage portion.

(2) Appellant Was Not Deprived of Due Process

Appellant contends the absence of constraints upon arbitrators in awarding

punitive damages and lack of judicial review result in a denial of its due process rights, citing Pacific Mut. Life Ins. Co. v. Haslip (1991) 499 U.S. 1 [113 L.Ed.2d 1; 111 S.Ct. 1032]. In Haslip, the Supreme Court addressed the constitutionality of jury-awarded punitive damages which were four times the amount of the compensatory damages. The award was upheld after the Supreme Court found that the record supported the award, and that the procedural safeguards employed by the Alabama trial and appellate courts did not violate due process principles.

Appellant claims that because there were no "meaningful constraints" upon the arbitrators nor sufficient facts to support the award, the arbitrators' award of punitive damages was arbitrary and

capricious. A similar argument was rejected by the Ninth Circuit in Todd Shipyards Corp. v. Cunard Line, Ltd., supra, 943 F.2d at p. 1063, decided approximately five months after Haslip, where the court found that the award did not result in a denial of due process to appellant since it had notice that respondent sought punitive damages, and was given the opportunity to present evidence, to argue the merits of its position, and to challenge the arbitrator's award. (Todd Shipyards Corp. v. Cunard Line, Ltd., supra, 943 F.2d at pp. 1063-1064; Raytheon Co. v. Automated Business Systems, Inc., supra, 882 F.2d at pp. 8-9.) Here appellant has not alleged any facts which would support its contention that the arbitrators acted arbitrarily and capriciously, facts which

would entitle it to move to vacate the award pursuant to Code of Civil Procedure section 1286.2, subdivisions (a), (b), (c), or (e). Appellant does not claim that it did not have notice of respondent's claim for punitive damages, nor that it was precluded from presenting any evidence or legal theories militating against such award. Moreover, the dispute was presented to a panel of three arbitrators, selected by the parties, which was much less likely than a jury to be swayed by passion and prejudice. (See Willoughby Roofing & Supply v. Kajima Intern., supra, 598 F.Supp. 353, 358, 363 ["Indeed, an arbitrator steeped in the practice of a given trade is often better equipped than a judge not only to decide what behavior so transgresses the limits of acceptable commercial practice in that

trade as to warrant a punitive award, but also to determine the amount of punitive damages needed to (1) adequately deter others in the trade from engaging in similar misconduct, and (2) punish the particular defendant in accordance with the magnitude of his misdeed. See generally, Note, Punitive Damages in Arbitration: The Search for a Workable Rule, 63 Cornell L.Rev. 272 (1978)."] We therefore find no violation of its due process rights.

California has already addressed the issue of the lack of judicial review of punitive damage arbitration awards in Baker v. Sadick, supra, 162 Cal.App.3d 618, 630. That opinion stated: "Finally, we are not persuaded by the argument if an arbitrator is permitted to award punitive damages in medical

malpractice claims submitted to arbitration agreements to arbitrate will be discouraged because punitive damages awards are not reviewable. A holding [that] punitive damages may be awarded in arbitration of a medical malpractice claim required to be submitted to arbitration by an arbitration agreement as broad as the one here involved does not divest the parties of their power to control the scope of arbitration by the terms of their agreement." (Ibid.) We find nothing in Haslip that warrants alteration of this policy.

In light of the overwhelming policy arguments favoring arbitration as an alternative dispute resolution forum, as enunciated in Moncharsh v. Heily & Blase, supra, 3 Cal.4th 1, we see no reason to limit those awards where parties have

agreed to resolve their disputes outside the judicial forum.

(3) Respondent's Request for Sanctions is Denied

Respondent requests attorney's fees and penalties on the grounds that the appeal is frivolous. Although we have determined that the appeal is not meritorious, we do not conclude that it was frivolous. We therefore deny respondent's request.

DISPOSITION

The judgment confirming the arbitration award is affirmed. Respondent is awarded her costs on appeal.

CERTIFIED FOR PUBLICATION.

/s/ Nott, J.

We concur:

/s/ Gates, Acting P.J.
GATES

/s/ Fukuto, J.
FUKUTO

APPENDIX B

DENIAL OF
DISCRETIONARY REVIEW
BY THE CALIFORNIA SUPREME COURT

Second Appellate District,
Division Two, No. B070514
S035102

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

IN BANK

SUPREME COURT
FILED NOV. 24, 1993

J. ALEXANDER SECURITIES INC., Appellant

v.

SIGNE MENDEZ, Respondent

Petition for review DENIED.

Mosk, J. and Kennard, J. are of the opinion the petition should be granted.

The request for an order directing depublication of the opinion is denied.

Arabian
Acting Chief Justice

APPENDIX C

CONSTITUTIONAL PROVISIONS,
STATUTES AND RULES INVOLVED

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

1. Constitution of the United States. The Fourteenth Amendment provides in relevant part:

> No State shall . . . deprive any person of life, liberty, or property, without due process of law; not deny to any person within its jurisdiction the equal protection of the laws.

2. Federal Statute. Section 4 of the Federal Arbitration Act, July 30, 1947, C. 392, 61 Stat. 669, amended September 3, 1954, C. 1293, 68 Stat. 1233, codified at 9 U.S.C. § 4, provides in part:

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate

under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement.

3. California Statutes. Sections 1285 and 1286.6 of the California Code of Civil Procedure:

CCP §1285 provides in pertinent part:

> Any party to an arbitration in which an award

> has been made may petition the court to confirm, correct, or vacate the award.

CCP §1286.6 then specifies the grounds for correction of an award, stating the court:

> shall correct the award and confirm it as corrected if the court determines that: . . .
> (b) the arbitrators exceeded their powers but the award may be corrected without affecting the merits of the decision upon the controversy submitted. . .

4. NASD Code of Arbitration Procedure.

Section 19:

> (b) In arbitration matters involving public customers and where the amount in controversy

exceeds $30,000 . . . the Director of Arbitration shall appoint an arbitration panel which consists of no fewer than three (3) nor more than five (5) arbitrators, at least a majority of whom shall not be from the securities industry, unless the public customer requests a panel consisting of at least a majority from the securities industry.